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## **J.P. Morgan Buys Bear in Fire Sale, As Fed Widens Credit to Avert Crisis**

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Pushed to the brink of collapse by the mortgage crisis, Bear Stearns Cos. agreed -- after prodding by the federal government -- to be sold to J.P. Morgan Chase & Co. for the fire-sale price of \$2 a share in stock, or about \$236 million.

Bear Stearns had a stock-market value of about \$3.5 billion as of Friday -- and was worth \$20 billion in January 2007. But the crisis of confidence that swept the firm and fueled a customer exodus in recent days left Bear Stearns with a horrible choice: sell the firm -- at any price -- to a big bank willing to assume its trading obligations or file for bankruptcy.

"At the end of the day, what Bear Stearns was looking at was either taking \$2 a share or going bust," said one person involved in the negotiations. "Those were the only options."

To help facilitate the deal, the Federal Reserve is taking the extraordinary step of providing as much as \$30 billion in financing for Bear Stearns's less-liquid assets, such as mortgage securities that the firm has been unable to sell, in what is believed to be the largest Fed advance on record to a single company. Fed officials wouldn't describe the exact financing terms or assets involved. But if those assets decline in value, the Fed would bear any loss, not J.P. Morgan.

The sale of Bear Stearns and Sunday night's move by the Fed to offer loans to other securities dealers mark the latest historic turns in what has become the most pervasive financial crisis in a generation. The issue is no longer whether it will yield a recession -- that seems almost certain -- but whether the concerted efforts of Wall Street and Washington can head off a recession much deeper and more prolonged than the past two, relatively mild ones.

### **'Uncharted Waters'**

Former Treasury Secretary Robert Rubin last week described the situation as "uncharted waters," a view echoed privately by top government officials. Those officials have been scrambling to come up with new tools because the old ones aren't suited for this 21st-century crisis, in which financial innovation has rendered many institutions not "too big too fail," but "too interconnected to be allowed to fail suddenly."

Simultaneously with the announcement of Bear Stearns's sale, the Fed took the extraordinary measure of allowing securities firms to borrow from the central bank under terms normally reserved for regulated banks. People close to Bear Stearns were bitter about the move, saying that had the Fed acted earlier, the firm could potentially have survived by borrowing directly from the Fed and using its troubled securities as collateral.

The deal already is prompting howls of protest from Bear Stearns shareholders, since the New York company last week indicated that its book value was still close to its reported level of about \$84 share at the end of the fiscal year. "Why is this better for shareholders of Bear Stearns than a Chapter 11 filing?" one Bear shareholder asked J.P. Morgan executives in a conference call last night.

J.P. Morgan referred the question to Bear Stearns executives, who weren't on the conference call. In a statement, Bear Stearns Chief Executive Alan Schwartz said the deal "represents the best outcome for all of our constituencies based upon the current circumstances."

One person familiar with the sale process said federal officials delivered a decisive prod to the firm's directors. "The government said you have to do a deal today," this person said. "We may not be there tomorrow to back you up."

### **Shock Waves**

The Fed, according to a person familiar with the matter, didn't care so much about the equity holders and was trying to prevent a bankruptcy filing that could have sent shock waves through the markets.

Bear Stearns's fortunes started to take a dramatic turn for the worse on Thursday as its trading partners started making margin calls. By Thursday night, Bear had told government officials that it might have to file for bankruptcy protection.

On Friday, after the Fed and J.P. Morgan agreed to provide emergency funding to the firm, its stock went into a free fall. Late Friday, credit-ratings firms downgraded Bear Stearns to two or three levels above junk status. The downgrades also had a big impact on Bear Stearns's viability, as they severely crimped the firm's number of potential trading partners.

By Friday evening, the walls were closing in around Bear. Banks and other counterparties were refusing to do any business with it at all. They stopped taking collateral on short-term lines of credit, even those backed by the highest-quality mortgage bonds backed by Fannie Mae and Freddie Mac. Prime-brokerage clients were also fleeing. So much was moving out of Bear accounts, that a final accounting was still going on through the weekend.

For the Bear executives and advisers -- including Lazard Deputy Chairman Gary Parr and veteran takeover lawyers Peter Atkins of Skadden, Arps, Slate, Meagher & Flom, Sullivan & Cromwell's H. Rodgin Cohen, and Cadwalader Wickersham & Taft's Dennis Block -- it became increasingly apparent a bankruptcy was imminent absent a sale.

A number of potential buyers came to inspect what Bear had to offer, including private-equity investors J.C. Flowers & Co. and Kohlberg Kravis Roberts & Co., as well as banks Barclays PLC and Royal Bank of Canada. None of them could put together a deal by last evening.

Bankers worked through Saturday and were close to reaching a deal around midnight that would have valued Bear Stearns at more than the \$2-a-share terms announced in the final deal. But on Sunday morning, that deal began to crumble as J.P. Morgan executives grew increasingly concerned about their exposure. The negotiating teams scrambled for a solution. The goal: to reach a deal before the markets in Asia opened this morning.

By late afternoon, however, the two sides had reconciled their differences and the current deal began to take hold.

In addition to James Dimon, its chairman and chief executive, J.P. Morgan brought in its most senior executives to hammer out the deal. Among them were Michael Cavanagh, chief financial officer, Steve Black and Bill Winters, co-heads of the J.P. Morgan's investment bank, and Stephen Cutler, the firm's general counsel.

James Cayne, Bear Stearns's chairman, who had been participating in a bridge tournament when the crisis unfolded, returned to New York on Saturday and participated in the negotiations, said one person familiar with the discussions.

"We're very comfortable with what we found [in due diligence] and what we acquired, but we needed a pretty substantial cushion" from the Fed, Bill Winters, co-head of J.P. Morgan's investment bank, said in a conference call last night.

The deal is expected to close by the end of June, an unusually quick time frame. Federal regulators already have signed off on the deal, which will require a vote of Bear Stearns shareholders.

Late yesterday, some Bear Stearns employees and shareholders were grumbling about the deal. If the feeling is widespread it could emerge as a potential obstacle to the completion of the deal because Bear Stearns employees own about a third of the company's shares.

"I've got to think we can get more in a liquidation, I'm not selling my shares, this price is dramatically less than the book value Alan Schwartz told us the company is worth," said a midlevel Bear Stearns executive. "The building is worth \$8 a share."

Many well-known investors, from billionaire Joe Lewis to Bruce Sherman, the head of Legg Mason Inc.'s Private Capital Management Inc. money-management firm, have seen the value of their stakes in Bear Stearns plummet. The pain could be most acute for Bear Stearns's employees.

"We have every expectation that Bear Stearns shareholders will approve the deal," Mr. Winters said.

With the deal, J.P. Morgan is essentially getting Bear's coveted prime brokerage business for free. It is twice the size of Bank of America's prime brokerage, which is on the auction block for about \$1 billion, according to a person familiar with the matter.

"J.P. Morgan Chase stands behind Bear Stearns," said J.P. Morgan's Mr. Dimon. "Bear Stearns' clients and counterparties should feel secure that J.P. Morgan is guaranteeing Bear Stearns' counterparty risk."

### **Betting on Merger Deals**

In addition to the prime brokerage business, J.P. Morgan is also likely to integrate Bear's clearing business, and some of its fixed-income and equity-trading operations. Furthermore, Bear Stearns also has an energy-trading business, which could fit into J.P. Morgan's fledgling energy operations. Bear is also well-known for its risk-arbitrage business in which traders bet on the

outcome of merger deals. Bear's investment-banking unit is of less interest to J.P. Morgan, however.

Through the weekend, Bear Stearns bankers were summoned to the company's headquarters on New York's Madison Avenue, where they were told to prepare lists of ongoing deals and business relationships. Representatives from prospective buyers circulated through conference rooms, with J.P. Morgan executives asking questions of Bear Stearns's senior management.

Analysts and investors still are bracing for more bad news as securities firms report earnings this week, though Bear Stearns's results are expected to surpass the average estimate from analysts surveyed by Thomson Financial, say people familiar with the matter. A Bear spokesman declined to comment.

### **Shaky Ground**

Meanwhile, worries persist that other securities firms and commercial banks might be on shaky ground. Lehman Brothers Holdings Inc. Chief Executive Richard Fuld, concerned about the markets and possible fallout from Bear Stearns's troubles, cut short a trip to India and returned home Sunday, ahead of schedule, according to people familiar with the matter. The decision came after a series of calls Saturday to both senior executives at the firm and Treasury Secretary Henry Paulson, these people say.

Investors' concerns that the flight of worried Bear Stearns customers last week might spread to other firms is likely to make for a tense opening today on Wall Street, despite the J.P. Morgan deal. Senior Fed officials told reporters that no major U.S. securities firm is in a similar situation to Bear Stearns. Yesterday, Mr. Paulson said in a TV interview that the government "would do what it takes" to protect the integrity of the financial system.

On several occasions over the weekend, Mr. Paulson spoke about the Bear Stearns negotiations with Federal Reserve Chairman Ben Bernanke and New York Federal Reserve Bank President Timothy Geithner, according to people familiar with the matter.

Bankruptcy experts said filing for bankruptcy protection wouldn't have been an attractive option for Bear Stearns, partly due to recent changes in the federal Bankruptcy Code.

"They can send you a letter saying the value of the assets is falling, so either pay us back or we will liquidate the asset," said Holly Etlin, a managing director at AlixPartners, a turnaround and business advisory firm.

Financial regulators beefed up their presence inside Bear Stearns over the weekend. Staff from the Securities and Exchange Commission's examinations group and trading and markets division, which monitors capital levels for soundness, worked with representatives from Wall Street's self-regulator, the Financial Industry Regulatory Authority, and Federal Reserve.

### **Unwinding Positions**

The SEC and Finra staff inspected Bear Stearns's books to ensure that if customers began pulling their accounts that there was a process to unwind the positions fairly, so as to prevent additional losses. The regulators also were monitoring the brokerage firms' capital levels amid speculation

that they too could face liquidity problems. A person familiar with regulators said the moves weren't meant to suggest that any particular firm was in trouble, rather it was to examine whether there was enough cash on hand to deal with potential problems.

The deal could potentially affect J.P. Morgan's plans to build a new facility for its investment bank at the World Trade Center site in lower Manhattan. Bear's new headquarters is located only steps from J.P. Morgan's Park Avenue headquarters in midtown Manhattan.

Bear Stearns's sudden meltdown forced the federal government to come to grips with the potential collapse of a major Wall Street institution for the first time in a decade. In 1998, about a dozen firms, with encouragement from the Federal Reserve Bank of New York, provided a \$3.6 billion bailout of Long-Term Capital Management that kept the big hedge fund alive long enough to liquidate its positions. Bear Stearns famously refused to participate in that rescue.

The scale of the financial system's troubles are even bigger this time around. Since last summer, the Fed has lowered its target for the federal-funds rate, charged on low-risk overnight loans between banks, to 3% from 5.25%, and it is expected to cut the rate again this week. Last week, the Fed said it would lend Wall Street as much as \$200 billion in exchange for a roughly equivalent amount of mortgage-backed securities.

But those moves have failed to soothe investors and lenders, who are worried about the true value and default risk of many debt securities or are hoarding cash to meet their own needs. As worries grew that failing to find a buyer for the beleaguered investment bank could cause the crisis of confidence gripping Wall Street to worsen across the financial system, federal regulators pushed Bear Stearns's board to sell the firm.